STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

MANHATTAN FIRE EXTINGUISHER, INC. :

for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Taxes under Article 22 of the Tax Law and the Administrative Code of the City of New York for the Period January 1, 1989 through December 31, 1991. :

In the Matter of the Petition :

of :

MANHATTAN FIRE EXTINGUISHER, INC. : DETERMINATION
DTA NO. 813561,

for Redetermination of a Deficiency or for Refund of New York State Corporation Franchise Tax under Article 9A of the Tax Law for the Period February 1, 1988 through January 31, 1992. : 813562, 813563

In the Matter of the Petition :

of :

RICHARD WACHTELL
AND FRANCINE WACHTELL :

for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Taxes under Article 22 of the Tax Law and the Administrative Code of the City of New York for the Years 1990 and 1991. :

Petitioner, Manhattan Fire Extinguisher, Inc., c/o Martin H. Bodian, Esq., 425 Broad Hollow Road, Melville, New York 11747, filed a petition for redetermination of a deficiency or for refund of personal income taxes under Article 22 of the Tax Law and the Administrative Code of the City of New York for the period January 1, 1989 through December 31, 1991.

Petitioner, Manhattan Fire Extinguisher, Inc., c/o Martin H. Bodian, Esq., 425 Broad Hollow Road, Melville, New York 11747, filed a petition for redetermination of a deficiency or for refund of New York State Corporation Franchise Tax under Article 9A of the Tax Law for the period February 1, 1988 through January 31, 1992.

Petitioners, Richard Wachtell and Francine Wachtell, 67-38 108th Street, Forest Hills, New York 11375, filed a petition for redetermination of a deficiency or for refund of personal income taxes under Article 22 of the Tax Law and the New York City Administrative Code for the years 1990 and 1991.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on November 2, 1995 at 1:30 P.M. Petitioners filed letter briefs on January 15, 1996 and March 20, 1996 which commenced the six-month period for the issuance of this determination. The Division of Taxation filed a letter brief on February 21, 1996.[1] Petitioners appeared by Martin H. Bodian, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Michael J. Glannon, Esq., of counsel).

ISSUE

I. Whether the Division of Taxation correctly determined that Manhattan Fire Extinguisher, Inc. improperly failed to deduct and remit withholding taxes to New York State and New York City with respect to compensation paid to certain individuals during the years at issue.

II. Whether it was erroneous for the Division of Taxation to estimate withholding tax rates for New York State and New York City of, four percent and two percent, respectively.

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[1]It is noted that the Division of Taxation's brief was accepted although it was received two days after the due date (Matter of O'Keh Caterers Corporation, Tax Appeals Tribunal, November 13, 1992).

III. Whether it was erroneous for the Division of Taxation to estimate that 24 percent of the gross receipts of Manhattan Fire Extinguisher, Inc. were deductible payroll expenses of the drivers/installers and telephone solicitors.

IV. Whether it was proper for the Division of Taxation to disallow the amount claimed as cost or other basis of property plus expenses of sale on the sale of a building at 87-82 Sutphin Boulevard, New York, New York because petitioners did not offer any substantiation for the amounts claimed.

V. Whether penalties asserted by the Division of Taxation pursuant to Tax Law §§ 685(b)(1) and (2) and Tax Law §§ 1085(b)(1) and (2) for negligence and the penalties asserted pursuant to Tax Law §§ 685(p) and 1085(k) for substantial understatement of liability should be abated.

FINDINGS OF FACT

1. Petitioner, Manhattan Fire Extinguisher, Inc. ("Manhattan Fire"), was a firm which sold and serviced fire extinguishers. The firm engaged individuals, known as "drivers/installers" ("drivers") to obtain fire extinguishers which were located at customer's premises and take them to a warehouse, maintained by Manhattan Fire, for service.

2. Petitioner, Richard Wachtell, started Manhattan Fire in or about 1978 or 1979. During the periods in issue, he was the president and only shareholder of the company.

3. Manhattan Fire filed a New York State S Corporation Franchise Tax Return for the fiscal year ending January 31, 1991. The return included a U.S. Income Tax Return for an S Corporation. In its computation of ordinary income, the latter return reported deductions for compensation of officers of $75,000.00 and salaries and wages of $139,100.00. Under the category of other deductions, Manhattan Fire claimed deductions for outside sales commissions of $177,500.00 and professional fees of $18,745.00. On the schedule of costs of goods sold, petitioner included as "[o]ther costs" outside labor in the amount of $614,182.00.

4. Manhattan Fire filed a New York S Corporation Franchise Tax Return for the fiscal year ended January 31, 1992. The return included a U.S. Income Tax Return for an S

Corporation for the fiscal year ending January 31, 1992. Under deductions, Manhattan Fire reported compensation of officers of $100,000.00 and salaries and wages of $170,660.00. Under the category of other deductions, Manhattan Fire reported outside sales commissions of $171,377.00 and professional fees of $15,219.00. In the cost of goods sold section of the return Manhattan Fire reported as "[o]ther costs" outside labor in the amount of $568,049.00.

5. Petitioners, Richard and Francine Wachtell, filed a joint New York State Resident Income Tax Return for the years 1990 and 1991. To the extent at issue here, petitioners return for the year 1990 reported a gain from the sale of a building at 87-82 Sutphin Boulevard in the amount of $41,962.00. The gain was calculated as follows:

Gross sales price	$250,000.00
Cost or other basis plus expense of sale	227,788.00
Depreciation	19,750.00
Adjusted basis	208,038.00
Total gain	41,962.00

6. The Division conducted an audit of the returns of Manhattan Fire and of Richard and Francine Wachtell. The Division's audit report, which concerned asserted deficiencies in withholding taxes, corporation franchise taxes and income taxes stated, among other things, that field audits were conducted at the office of Manhattan Fire's accountant on May 28, 1992 and July 28, 1992. On both dates, books and records were either unavailable or inadequate. On the second audit date, petitioners' accountant presented a letter from Manhattan Fire's insurance carrier which stated that some records were destroyed due to burglaries. However, petitioners were not specific about what records were lost or stolen. The audit report notes that no checks were available for 1989 and only some checks were available for 1990 and 1991. At a conference held on December 11, 1992, petitioners' accountant stated that the drivers and telephone solicitors were paid in cash until August 1990.

7. In accordance with its' request, the Division was given a schedule of the drivers and telephone solicitors from 1989 through 1991 with the name and the amount claimed as earned. However, for 1989 petitioners did not have the amount earned for some drivers. The Division also ascertained that the amount shown on the schedules significantly differed from the amount

shown on the Form 1099's and that neither the Form 1099's nor the schedules submitted reconciled with the expenses claimed on the corporate returns.

8. The Division found that the checks submitted for 1991 were substantially lower than the expense claimed for independent contractors on the corporate return for the fiscal year ended January 31, 1992. Petitioners' accountant later stated that the Form 1099 amounts were lower than the amounts claimed on the tax returns because some of the telephone solicitors were paid less than $600.00 and therefore Form 1099's did not have to be issued.

9. For the year 1989, the Form 1099's totaled $550,034.34. A schedule prepared by petitioner's representative showed that the amount of the drivers' compensation was $166,381.44 and that the amount of the telephone solicitors compensation was $172,672.94.

10. According to one of the audit reports, for the year 1990, the Form 1099's totaled $390,140.90. A schedule prepared by petitioners' representative showed that the total amount of the drivers' compensation was $145,823.27 and that the total amount of the telephone solicitors' compensation was $158,573.12.

11. For the year 1991, the Form 1099's totaled $434,391.78. A schedule presented by Manhattan Fire's accountant showed that the driver's total compensation was $158,448.77 and that the telephone solicitor's total compensation was $262,891.99.

12. During the audit, petitioners' representative stated that the expenses claimed on the tax returns for outside labor, commissions and wages were determined on a cash basis for a calendar year despite the fact that the tax returns were prepared on a fiscal year basis.

13. With respect to the question of whether the drivers were independent contractors, the Division was advised that the drivers were listed for unemployment insurance purposes. Further, the Division learned that the drivers received a flat stipend of $37.00 for gasoline and that this was Manhattan Fire's only expense.

14. The Division was informed that the drivers set their own routes and that they were able to set their own hours although they were expected to report before noon for work. Petitioners also stated that the drivers were free to leave the job whenever they wished although

Mr. Wachtell conceded that he had the right to discharge a driver. During the audit, petitioners explained that the job required no technical expertise or training. Further, the drivers were paid by the number of stops made and if a customer did not pay, the amount would be subtracted from the next check. The audit report further noted that Manhattan Fire did not produce any documentation, such as invoices, to show that the drivers were in business for themselves.

15. Upon reviewing the records of Manhattan Fire, the Division of Taxation ("Division") disallowed all or a portion of certain expenses which were claimed on the tax returns. To the extent at issue here, the Division estimated that 24 percent of the gross receipts of Manhattan Fire for the fiscal years ending January 31, 1989 through January 31, 1991 were payroll expenses. The Division's estimate was based upon its determination to allow $434,392.00 in expenses for the drivers and telephone solicitors for the fiscal year ended January 31, 1992. The amount allowed was approximately 24 percent of the gross receipt for said fiscal year. The Division was not presented with any checks to substantiate the expense for the drivers or telephone solicitors for the fiscal years ending January 31, 1989 and January 31, 1990.

16. On the basis of its audit, the Division issued a Notice of Deficiency, dated July 6, 1993, which asserted a deficiency of corporation franchise tax for the fiscal years ending January 31, 1989, January 31, 1991 and January 31, 1992 in the amount of $30,582.73 plus interest in the amount of $8,555.58 and penalty in the amount of $8,719.48 for a balance due of $47,857.79. The penalties were imposed pursuant to Tax Law § 1085(b)(1) for negligence, Tax Law § 1085(b)(2) which is a penalty on interest due to negligence and Tax Law § 1085(k) for substantial understatement of a liability. The penalties were imposed because Manhattan Fire had inadequate books and records and because the Division concluded that there were exaggerated deductions that could not be substantiated.

17. The Division also determined that the drivers and telephone solicitors/salesmen that Manhattan Fire treated as independent contractors were employees subject to New York State and New York City withholding tax. The Division further concluded that the New York State

and New York City withholding tax rates for the drivers and telephone solicitors/salesmen were four percent and two percent, respectively. The Division felt that theses rates were reasonable because of the lack of documentation corroborating the payments to the drivers and telephone solicitors. In the audit report, the Division reasoned that the withholding tax required for a payment of $10,000.00 would change if the payment were made at one time as opposed to a series of payments over the course of a year. The Division also speculated that there may have been large "consulting payments" that were made to the officer of the company which were reported on the corporate tax returns as outside labor or outside commission expenses.

18. On the bases of the foregoing conclusions, the Division issued a series of notices of deficiencies, dated April 26, 1993, which asserted a deficiency of New York State withholding tax as follows:

Period	Tax	Interest	Penalty	Balance Due
01/15/89 - 12/31/89	$ 9,192.00	$4,099.28	$2,509.23	$15,800.51
01/15/90 - 12/31/90	16,176.00	5,203.86	3,410.72	24,790.58
01/15/91 - 12/31/91	17,376.00	2,875.61	2,306.59	22,558.20

19. The Division also issued a series of notices of deficiency, dated April 26, 1993, which asserted a deficiency of New York City withholding tax as follows:

Period	Tax	Interest	Penalty	Balance Due
01/15/89 - 12/31/89	$ 4,608.00	$2,055.03	$1,257.90	$ 7,920.93
01/15/90 - 12/31/90	8,088.00	2,601.94	1,705.35	12,395.29
01/15/91 - 12/31/91	8,688.00	1,437.80	1,153.27	11,279.07

20. The Division imposed negligence penalties on the asserted deficiencies of withholding tax because of the inadequate books and records of Manhattan Fire and because of the Division's conclusion that there was no reasonable basis to consider the drivers and telephone solicitors independent contractors rather than employees.

21. In conjunction with the forgoing audits, the Division conducted an examination of the personal income tax returns of Richard and Francine Wachtell. To the extent at issue here, the Division estimated an additional gain of $208,038.00 on the sale of the building at 87-82 Sutphin Blvd., Jamaica, New York. The Division felt that the basis in the building should be zero because of the lack of substantiation. As a result of the adjustment, the Division concluded that petitioners had a gain of $250,000.00 on the sale of the property.

22. The Division issued a Notice of Deficiency to Richard Wachtell and Francine Wachtell, dated June 21, 1993, which asserted a deficiency of New York State and New York City personal income tax for the years 1990 and 1991 in the amount of $84,169.46 plus interest in the amount of $9,371.82 and penalty in the amount of $17,311.32 for a balance due of $110,852.60. The penalties were asserted pursuant to Tax Law § 685(b) for negligence and Tax Law § 685(p) for substantial understatement of liability.

23. Manhattan Fire had two classes of employees - drivers and telephone solicitors. At the hearing, petitioner conceded that the telephone solicitors were employees subject to withholding tax but continued to argue that the drivers were independent contractors.

24. Each driver procured the fire extinguishers in his or her own van. The expenses of operating each van were paid for by the driver.

25. Manhattan Fire located its drivers by advertising in a newspaper. A driver was expected to have a van and a license to drive. He was also expected to have automobile insurance and be familiar with the roads in the borough in which he would be working.

26. Manhattan Fire needed 10 to 13 drivers each day. Mr. Wachtell did not know how many drivers would appear for work on a given day because the drivers appeared on an erratic basis. Some of the drivers worked for Manhattan Fire every day while other drivers also spent time working for other people. Drivers were not required to work on particular days and did not have any required hours of work.

27. The drivers were paid weekly on the basis of the deliveries that were made. The level of compensation was determined by a percentage of the amount that was shown on the invoice. The drivers did not receive sick pay or vacation benefits.

28. Manhattan Fire's salesmen prepared handwritten invoices following their contact with customers. The invoices were then processed by an employee of Manhattan Fire. When a driver appeared for work he was given a group of the invoices which informed the driver where he had to go and what he was expected to do.

29. It is Mr. Wachtell's understanding that fire extinguishers in New York City had to be placed on a hook five feet from the ground. Occasionally, a hook broke and, if it was requested by a customer, the driver would place the fire extinguisher on a new hook. Also, if there was a new customer who did not have a hook, the driver might install a hook.

30. The drivers were required to have the invoices signed by the customers to show that the delivery had been made. The signed invoices were submitted by the drivers the next time they appeared for work.

31. If necessary, Mr. Wachtell could decide not to assign work to a particular driver.

32. At the hearing, the representatives of the parties agreed that they would try to determine the amount of the labor expense that was attributable to the drivers as opposed to the telephone solicitors. Subsequently, petitioners' representative submitted a letter which stated that a comparison of the drivers per the 1990 Form 1099's to the total of all of the Form 1099's shows that 46.5 percent of the total payroll was for drivers which petitioners' claim were independent contractors rather than employees. In support of this assertion, petitioners' representative included a schedule which listed 16 drivers and the amount they earned. The proposed 46.5 percent was determined by dividing the total compensation attributed to the drivers of $184,391.47 by the total of the Form 1099's of $396,477.68.

33. In order to challenge the Division's estimate of the percentage of Manhattan Fire's gross receipts which were subject to, respectively, Federal and State withholding, petitioner offered a schedule, based on the Form 1099's which were offered into evidence, which stated

that the total amount of the 1099's, issued was $396,477.68. Petitioner then found that the average amount of the Form 1099's which were issued in 1990 was $7,480.71 by dividing the total of the Form 1099's by the number of Form 1099's issued in 1990. The effective New York State and New York City tax rates were calculated as follows:

Assume standard deduction (nondependent)	$6,000.00
Taxable income	1,480.71
Tax (assume single) - NYS	59.00
- NYC	37.00

NYS Tax 59 = .008% effective NYS rate
Average 1099 amount 7481

NYC Tax 37 = .005% effective NYC rate
Average 1099 amount 7481

Proposed NYS Tax Rate 1%
Proposed NYC Tax Rate ½%

34. Petitioner performed the same calculation for the year 1991 as follows:

Total of 1099's issued in 1991	$434,391.78
Number of 1099's issued	÷54
Average 1099 amount	$ 8,044.29

Assume standard deduction (nondependent)	$ 6,000.00
Taxable income	2,044.29
Tax (assume single) - NYS	81.00
- NYC	51.00

NYS Tax 81 = .01 Effective tax rate
Average 1099 amount 8044

NYC Tax 51 = .006 Effective tax rate
Average 1099 amount 8044

Proposed NYS withholding tax rate 1%
Proposed NYC withholding tax rate ½%

35. As noted, in computing the asserted deficiency of corporation franchise tax, the Division allowed 24 percent of gross receipts as a payroll expense. At the hearing, petitioners offered the following schedule in support of their position that 27 percent of gross receipts should be utilized to calculate deductible independent labor. This schedule provided as follows:

"Independent Labor per 1099's - 1990	$ 396,477.68
1991	434,391.78

		$ 830,869.46
Note: Under $600. (non 1099) independent labor represents 15% of 1099 amount		$ 124,630.42
		$ 955,499.88
		÷2
	Avg	$ 477,749.94
Gross Receipts per 1120S - 1/31/91		$1,685,797.00
- 1/31/92		1,788,200.00
		$3,473,997.00
		÷2
	Avg	$1,736,998.50
	Avg Independent Labor	$ 477,749.94
	Avg Gross Receipts	1,736,998.50
		=
		27%"

36. Following the audit of Richard and Francine Wachtell's personal income tax returns, the Division adjusted the gain on the sale of the building at 87-82 Sutphin Boulevard, Jamaica, New York 11435 by disallowing the claimed improvements. At the hearing, petitioner offered the following list of improvements:

"1973 thru 1990

1. Renovated 3rd floor apartment
   3 rooms converted into office space
   Repaired roof and water proofing 20,000

2. Renovated 2nd floor
   Remodeled and rented offices to
   Real Estate firm 15,000

3. Renovated storefront - 1st time
   Rented to grocery store
   Steel roll down gates and doors 10,000

4. Renovated storefront - 2nd time
   Rented to insurance broker 7,000

5. Renovated interior & exterior of 2nd
   floor - structural repairs, beams and
   over hanging roof. Repaired roof 2nd time 15,000

6. Boiler - Purchased (2) boilers - Weil McLain
   Purchase (2) water heaters 8,000

7. Electrical work - upgrade building to
   220 wiring, electric design, circuit breaker
   panels, new thermostats installed and
   dedicated lines 15,000

8. General maintenance yearly - $3,000 per year includes window repairs, new doors, new locks and keys, plumbing repairs, electrical work, carpentry repairs, painting, boilers repairs, lighting fixtures & bulbs, new barbed wire for roof, new window frames, replace leaders & gutters, repair & replace skylight 50,000

$140,000"

37. No documents or testimony were presented to substantiate any of the claimed improvements to the building.

38. At the hearing, petitioners argued that the penalties should be cancelled because the difficulty in obtaining records was due to a burglary. After the hearing, petitioners submitted documents showing that a burglary occurred at the premises of Manhattan Fire on September 9, 1992.

SUMMARY OF THE PARTIES POSITIONS

39. In their opening brief, petitioners argue: that the drivers should be classified as independent contractors who are not subject to payroll tax deductions; that the withholding tax rates proposed by the Division are excessive; that petitioners should be allowed to deduct the basis of the building sold from the selling price; that the payroll expense should be more than 24 percent of sales; and, that penalties should be waived.

40. In response, the Division argues that petitioners have not rebutted the presumption of correctness attached to the notices of deficiency. According to the Division, the twenty factors set forth in Revenue Ruling 87-41 plus the fact that the drivers were covered by Manhattan Fire's unemployment insurance and the fact that there were no employment contracts with the drivers should lead to the conclusion that the drivers were employees. The Division also argues that a burglary did not prevent petitioners from producing documents during the field audit because the burglary occurred after the field audit.

With respect to the argument that the withholding tax rates used by the Division were excessive and that payroll should be more than 24 percent of sales, the Division contends that the relief requested should not be granted because petitioners have not supported their arguments with documentary proof. The Division notes that the four percent and two percent

withholding tax rates used by the Division are within the percentages of withholding reflected in the wage bracket tables in the Commissioner's regulations. Lastly, the Division contends that petitioners have not proved that the basis of the 87-82 Sutphin Boulevard property was $208,038.00 as claimed on their 1990 resident income tax return.

41. In a reply brief, petitioners refer to the twenty factors set forth in Revenue Ruling 87-41 to show that Manhattan Fire did not have a sufficient degree of control to establish an employer - employee relationship with the drivers. Petitioners also assert that there were several burglaries and incidents of vandalism at Manhattan Fire's premises. The documents concerning the September 9, 1992 burglary were the only ones petitioners could obtain from the New York City Police Department.

It is also contended that the four percent and two percent withholding tax rates used by the Division are unacceptable and that one percent and one-half percent rates for New York State and New York City should be applied.

Petitioners submit that documentation has been supplied supporting the basis of the building shown on the tax return.

Lastly, it is argued that petitioners treated all employees as independent contractors in the belief that they were such. Petitioner's posit that the lack of records was beyond their control.

CONCLUSIONS OF LAW

A. The first question presented is whether it was proper for the Division to treat the drivers as employees subject to withholding tax.

Insofar as it is relevant here, Tax Law § 671(a)(1) requires employers maintaining an office or transacting business in New York State to deduct and withhold New York State personal income tax from the wages paid to its employees. Tax Law § 675 provides that employers required to deduct and withhold tax under Article 22 of the Tax Law are liable for such tax. The New York City Administrative Code contains similar provisions with respect to the withholding of New York City personal income and nonresident earnings taxes (see, Administrative Code §§ 11-1771, 11-1775, 11-1776, 11-1908, 11-1913, 11-1914).

B. It is concluded that guidance on the issue of whether the drivers were employees or independent contractors may be found in Matter of O'Keh Caterers Corporation (Tax Appeals Tribunal, June 3, 1993). In O'Keh the issue before the Tribunal was whether catering truck drivers were employees rendering their employer liable for the collection of the tax on the driver's sales or whether the drivers were independent contractors. The Tribunal's decision shows that the Administrative Law Judge considered the factors set forth in Revenue Ruling 87-41 and concluded that the drivers were employees.

On appeal, the Tribunal reached the opposite conclusion on the basis of Matter of Liberman v. Gallman (41 NY2d 774, 396 NYS2d 159). The Tribunal determined that the drivers were independent contractors by relying on the following facts:

> "First, the drivers rented the trucks and were responsible to purchase gas, oil and propane for the trucks; the drivers paid sales tax on the rental of the trucks; the drivers, not petitioner, were responsible for hiring and paying substitute drivers. Second, petitioner did not pay wages to the drivers. The drivers' compensation was their profit on sales to the customers. In addition, petitioner did not withhold income taxes on the drivers' behalf. Third, petitioner sold its merchandise to the drivers at a profit. The drivers bore the risk of loss with respect to these items and petitioner did not repurchase unsold items from the drivers. We also note that some of the drivers were registered sales tax vendors. Fourth, the manner in which petitioner designated and monitored routes does not amount to control or regulation of the manner in which the drivers attempted to solicit business, particularly since individuals at a specific site, not petitioner, decided the specific time of day when any given stop was to be made. Fifth, we are not persuaded by the Administrative Law Judge's reliance on the "integration" of the drivers into petitioner's business as a key factor in supporting an employee relationship. Liberman accounted for 75% of Reider's business activity and the Court did not find that a significant fact.
>
> In summary, we find that the totality of the evidence leads us to conclude that petitioner has met its burden of proving that the drivers were not employees" (Matter of O'Keh Caterers Corporation, Tax Appeals Tribunal, June 3, 1993).

In Liberman, the Court of Appeals found that there was sufficient evidence to support the determination that the taxpayer, who worked as a salesman, was an independent contractor and not an employee of the manufacturer. In reaching this conclusion, the Court discussed the applicable standard in the following terms:

> "[t]here is no dispute as to the standard to be applied in determining whether or not petitioner was an employee, as opposed to an independent contractor. 'The distinction between an employee and an independent contractor has been said to be the difference between one who undertakes to achieve an agreed result and to accept the directions of his employer as to the manner in which the result shall be

> accomplished, and one who agrees to achieve a certain result but is not subject to the orders of the employer as to the means which are used' [citation omitted]. It is the degree of control and direction exercised by the employer that determines whether the taxpayer is an employee [citations omitted]. 'From the nature of the problem the degree of control which must be reserved by the employer in order to create the employer-employee relationship cannot be stated in terms of mathematical precision, and various aspects of the relationship may be considered in arriving at the conclusion in a particular case' [citation omitted]" (Matter of Liberman v. Gallman, supra, 396 NYS2d at 161; emphasis added).

In reaching the conclusion that Mr. Liberman was not an employee, the Court relied on several factors: the employer did not have sufficient control; the taxpayer was responsible for paying for his own office space and clerical help; and the employer did not withhold income taxes from the taxpayer's commissions.

C. It is determined that O'Keh and Liberman warrant the conclusion that the drivers in this matter were independent contractors. First, while Manhattan Fire may have provided money for gasoline, the record shows that the drivers owned the vans and were otherwise responsible for the expenses of operating the vans. Second, as in O'Keh, the purported employer did not pay wages to the drivers. Rather, the compensation was based on the number of deliveries that were made and the amount that was shown on the invoice. Third, Manhattan Fire exercised very little control over its drivers. The drivers were just given an invoice directing them where to go and what to do. The drivers did not have to work on any particular day and did not have any required hours of work.

D. The arguments raised by the Division do not warrant a different result. The fact that the drivers received some instructions and oversight from Manhattan Fire such as reporting to Manhattan Fire in the morning for assignment and being required to submit signed invoices to show job completion does not make the drivers employees (see, Matter of Liberman v. Gallman, supra). Further, the training received by the drivers is not significant in view of the fact that the driver's duties were not complex.

The Division's reliance on the integration of the drivers into the business and the fact that the drivers rendered service personally is also misplaced. As noted by the Tribunal in O'Keh,

the taxpayer in Liberman accounted for 75 percent of the firm business and this was not considered significant.

Contrary to the Division's arguments, the evidence shows: that Manhattan Fire did not have a continuing relationship with many of its drivers, that the drivers did not have set hours of work and that at least some of the drivers worked for more than one employer. Under these circumstances, the few factors which would support the conclusion that the drivers were employees (e.g., the payment of a daily gas stipend, the inclusion of the drivers in Manhattan Fire's unemployment insurance and the fact that there were no employment contracts with the drivers) do not warrant a different finding.

E. Having concluded that the drivers were independent contractors, the next question is how much of the asserted deficiency of withholding tax was attributable to the drivers. As noted, petitioners' brief states that a listing of the drivers and their compensation per the 1990 Form 1099's and a comparison of the total amount paid to the drivers to total amount of the Form 1099's illustrates the fact that 46.5 percent of the total payroll was for drivers. The difficulty with this statement is that the analysis presented after the hearing is significantly different from the analysis of the driver's compensation offered on petitioners' behalf during the audit. During the audit, petitioners' representative presented a schedule which showed that, for 1990, driver's compensation was $145,823.27. In contrast, the schedule accompanying petitioner's brief states that the compensation was $184,391.47. Unfortunately, it is not possible to determine which schedule is accurate.

F. Under the circumstances presented, it is concluded that a more reliable estimate of the amount paid to the drivers may be obtained by using the information available for the fiscal year ended January 31, 1992 because this was the year in which the Division estimated the expenses of the drivers and the telephone solicitors. The record shows that the Division allowed $434,392.00 as expenses for the drivers and telephone solicitors for the fiscal year ended January 31, 1992. For approximately the same period, a schedule prepared by petitioner's accountant showed that the driver's total compensation was $158,448.77. On the basis of these

amounts, it is estimated that, for each of the years in issue, 36 percent of the total compensation attributed to the drivers and telephone solicitors represents the amounts paid to drivers which is not subject to withholding.

G. Petitioners argue that the withholding tax rates used to calculate the asserted deficiency of tax are excessive and propose, in the alternative, New York State and New York City withholding tax rates of one percent and one-half percent, respectively.

In support of their argument, petitioners presented certain schedules. The difficulty with their schedules is that the amounts listed on the schedules do not correspond with the amounts listed on the franchise tax returns. For the fiscal year ending January 31, 1991, Manhattan Fire reported that outside labor was $614,182.00. However, petitioners' accountant determined that during the same period the total amount of the Form 1099's was $396,477.68. Similarly, for the fiscal year ending January 31, 1992, Manhattan Fire reported outside labor of $568,049.00 while petitioners schedule states that the total of the Form 1099's was $434,391.78. In view of the large unexplained discrepancies between the franchise tax reports and the amounts used on the schedules, petitioners schedules are considered unreliable. Therefore, they have not sustained the burden of proof of establishing that the withholding tax rates used by the Division were erroneous (see, Matter of Tavolacci v. State Tax Commn., 77 AD2d 759, 431 NYS2d 174).

H. Petitioners also contend that the Division erred in estimating that 24 percent of Manhattan Fire's gross receipts represented deductible independent labor. According to petitioners, deductible independent labor equals 27 percent of Manhattan Fire's gross receipts.

Petitioners also offered a schedule in support of this argument. An examination of this schedule shows that it suffers from the same infirmity as was present in the schedule regarding withholding tax. That is, there is no correlation between the amount listed as independent labor and the amounts listed as outside labor on the franchise tax returns. Additionally, there is no support in the record for the position that the independent labor represents 15 percent of the Form 1099 amount. In view of the foregoing deficiencies, petitioners have not shown that their

estimate is any more reliable than that used by the Division. Therefore, an adjustment to the amount of deductible independent labor allowed by the Division is also unwarranted (see, Matter of Tavolacci v. State Tax Commn., supra).

I. As noted, because of lack of documentation, the Division disallowed any of the claimed improvements to the building at 87-82 Sutphin Boulevard in computing the gain on the sale of the building. At the hearing, petitioners offered a list of improvements which they claim should be considered in determining the amount of the gain. No documents or testimony were presented in support of the claimed adjustments. Under these circumstances, there is no basis to modify the adjustments made by the Division.

J. In order to abate the penalties imposed for negligence, petitioners must carry their burden of establishing that the deficiencies were not due to negligence (Tax Law §§ 685[b], 689[e], 1085[b], 1089[e]; see, Matter of Michael J. Blake, Tax Appeals Tribunal, April 23, 1992). The penalties imposed for the substantial understatement of liability may be waived if there is reasonable cause for the understatement or it is shown that the taxpayer acted in good faith (Tax Law §§ 685[p], 1085[k]).

K. Petitioners' representative submitted a series of documents showing that a burglary took place at the premises of Manhattan Fire on September 9, 1992 and that certain records were reported stolen. It is submitted that the burglaries warrant the abatement of penalties. However, the Division correctly noted that this burglary occurred after the field audit visits. Accordingly, the documents do not establish reasonable cause for the failure to produce documents at the time of the audit.

The Division's field audit report shows that at the second field audit visit, on July 28, 1992, the Division was presented with a letter dated July 13, 1991 from Manhattan Fire's insurance carrier stating that records were destroyed in the course of burglaries. Under theses circumstances, it is accepted that some records were destroyed during burglaries.

L. It is concluded that petitioners have not established that the penalties should be abated. While it is not disputed that Manhattan Fire was burglarized, there is no evidence in the record

as to the adequacy of the records before the burglaries. Further, there is no evidence as to what records were lost or destroyed due to the burglaries.

M. The petitions of Manhattan Fire Extinguisher, Inc., Richard Wachtell and Francine Wachtell are granted to the extent of Conclusion of Law "F" and the Division is directed to modify the appropriate notices of deficiency accordingly; except as granted, the petitions of Manhattan Fire Extinguisher, Inc., Richard Wachtell and Francine Wachtell are denied and the notices of deficiency, dated April 26, 1993, July 6, 1993 and June 21, 1993, are sustained together with such penalty and interest as may be lawfully due.

DATED: Troy, New York
September 19, 1996

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE